COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

No. 231

THE DIXIE, INC.,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner, here and in all Courts below, The Dixie, Inc., respectfully prays for a writ of certiorari to review the order and judgment of the United States Court of Appeals for the Second Circuit, and that said writ of certiorari issue to said Circuit Court, which possesses the record herein.

(a) *Opinions below.*

The opinion of said Circuit Court is officially reported in 277 Fed. 2d 526 and appears as appendix A hereto. The opinion of the Trial Court (Tax Court of the United States) is officially reported in 31 T C 415 and appears in appendix B hereto.

(b) *Jurisdiction.*

The order and judgment of said Circuit Court was made and entered on April 14, 1960. Jurisdiction is conferred upon this Court by 28 USC Sections 2101 and 1254.

(c) *Questions presented.*

This matter involves a deficiency of $22,053.11 in income surtax for the calendar year 1952 assessed under Section 102 of the 1939 Code.

Petitioner operates the Hotel Dixie in the City of New York, and has done so since 1942. Its net earnings for the calendar year 1952, after all taxes save the one in question, was $80,193.14. Petitioner retained these earnings, adding them to surplus.

The basic questions presented to this Court are:

1. Was the retention of these earnings by Petitioner beyond the reasonable needs of Petitioner's business within the meaning of Sec. 102(c) of the 1939 Internal Revenue Code?

2. Is the burden of proof as to question 1 upon Petitioner under Sec. 534 of the 1954 Internal Revenue Code?

3. Was Petitioner's purpose, in retaining the earnings, to prevent the imposition of surtax on its sole stockholder within the meaning of Sec. 102(a) of the 1939 Internal Revenue Code?

(d) *Statutes and Regulations involved.*

STATUTES: Section 102(a) and (c) (1939 Internal Revenue Code); Section 534(a), (b), (c) and (e) (1954 Internal Revenue Code).

REGULATIONS: Sec. 39.102-2 and Sec. 39.102-3 (Regulations, 1939 Code): Sec. 1.534-2 and Sec. 1.534-4 (Regulations, 1954 Code).

Relevant portions of the foregoing appear as appendix C hereto.

(e) *Statement of the case.*

(Page references are to Petitioner's Appendix.)

1. *As to Petitioner's business needs.* The addition of the $80,193.14 to surplus at the end of 1952 increased Petitioner's total surplus at that time to $708,660.81.

Of this sum the Tax Court determined that $450,000.00 was properly retained for Petitioner's business needs, finding as a fact that (A 17)

> "There existed two immediate needs for the Hotel Dixie which were discussed by the board during the years pertinent hereto, including 1952. These concerned the need for air-conditioning the entire hotel resulting from the action of other hotels in the Times Square area which were air-conditioning their rooms or had already done so, and the installation of television in each guest room.

and concluding in its opinion that (A 31)

> "We are willing to accept as reasonable the accumulation of up to $450,000 for air conditioning and television."

The Circuit Court below did not disturb this finding and sustained the Tax Court's further determination, that petitioner's other business needs, separately set forth below, were not shown sufficiently to justify the retention of any part of the balance, $258,660.81.

Petitioner's Regular Operating Expenses

In the context of petitioner's business $258,660.81 is not large. Petitioner stipulated gross income, gross operating expenses, capital expenses, etc., and net profits (before taxes) for the years 1948 through 1952 as follows (A 39):

	Gross Income	Gross Operating Expenses	Capital Expenses Etc.	Net Profit
1948	1,701,296.21	1,267,983.10	269,803.90	163,509.21
1949	1,565,520.12	1,199,148.80	253,886.76	112,484.56
1950	1,592,230.48	1,212,656.99	283,571.71	162,152.68*
1951	1,575,925.11	1,212,215.38	298,224.21	65,485.52
1952	1,639,498.75	1,215,001.50	273,221.03	151,276.22

(*Includes $66,150.00 gain on sale of bonds)."

In this connection $258,660.81 represents less than three months of petitioner's normal operating expenses.

The Tax Court made no mention of this fact nor of Petitioner's contention with respect to it; the Circuit Court below disposed of both as follows (Appendix A hereto p. 26):

> ". . . petitioner contends that under the Tax Court's own rulings in *J. L. Goodman Co.* v. *Commissioner*, 11 T. C. 530 and *F. E. Watkins Motor Co.*, 31 T. C. 31 (footnote 7: 'This Court has consistently held that the accumulation of funds to meet operational expenses for at least one year is reasonable') that its retention of the earnings and profits is *per se* reasonable in the context of its business, which incurs gross operating costs of over one million dollars per year.
>
> "The rule of thumb so stated may be one proper for administrative convenience but should rise to no higher level. The search must always be concerned with the needs of the particular business as they existed during the particular year."

Petitioner's Basement

The premises operated by petitioner as found by the Tax Court (A 7)

> ". . . at and above street level constitute a hotel of 620 rooms. The premises below the street level were originally designed and constructed for use as a bus terminal and were leased as a bus terminal to the Dixie Bus Depot, Inc., by written lease"

(which was to expire and did expire according to its terms on June 30, 1957). The bus terminal, about 15,000 square feet in area, occupied petitioner's entire basement space.

Under the terms of the lease the tenant was obligated to pay to petitioner as rent a percentage of its income but in any case at least $45,000.00 a year (A 9). The rent paid to

petitioner under the lease for the years 1948 through 1957 was (A 11):

"1948.....	$110,508.92	1953.....	$53,892.42
1949.....	116,242.91	1954.....	49,872.53
1950.....	109,420.85	1955.....	50,086.07
1951.....	59,092.10	1956.....	49,600.23
1952.....	53,561.81	1957.....	15,900.77"

The Tax Court found (A 11)

> "In 1950 the New York Port Authority Bus Depot at Eighth Avenue opened its facilities to bus-chartering companies, which resulted in the declining use of the Dixie Bus Depot by the chartering bus companies and an increasing likelihood that the Dixie Bus Depot, Inc., would not renew its lease in 1957."

and further that (A 16)

> "At the directors' meetings during 1952, among the problems which were discussed relative to Dixie (was) the anticipated loss of a tenant for the bus terminal in 1957 . . ."
>
> "Two alternative plans were advanced at the directors' meetings with respect to the bus terminal. One plan involved remodeling the basement, for suitable use by another tenant. However, no estimate was made of the cost which such remodeling might entail."

Actually, as the Tax Court itself subsequently found, petitioner did have an estimate made of the worst possible case, i.e., remodeling involving some of the supporting columns. Its finding was (A 16)

> "The hotel engineer did make a casual survey of the basement and estimated what he thought would be the cost of remodeling, based on total conversion of the basement to uses other than as a bus terminal

> and on the supposition that the columns supporting the entire building would be taken down or at least partially removed. He estimated the cost of such remodeling to be $500,000 in 1952. If the supporting columns were left undisturbed, the cost of reconstructing walls and office rooms would be much less than the plan for total removal would entail. However, no estimate of such cost was attempted by the petitioner or any agent of the petitioner."

The Tax Court's conclusion was (Opinion, A 30, A 31):

> "Under the circumstances, the $500,000 estimate is entitled to little weight. Moreover, even if we were inclined to accept the estimate itself as reasonable, the basis for that estimate was apparently only one of a number of alternative plans for conversion of the basement, and there is no evidence that petitioner's officers or directors adopted it or any other plan of remodeling. On the contrary, the weight of the evidence indicated that they hoped to find a new tenant who could use the basement facilities as they existed, with little or no renovation being required. As of the date of trial, no remodeling of the basement had been undertaken or authorized."

Whatever their hope may have been, the belief of petitioner's management was that the space would have to be remodeled, depending on the needs of an actual tenant, because the space could not be re-rented as a bus terminal (A 52).

As to the alternative plan the Tax Court found (A 16)

> "The second plan was that the hotel be remodeled at the first level and converted into rooms available for guests, and that the basement be converted into space into which the offices of the Dixie, King, and Carter could then be moved. However, the extent of the planning to this end in the year 1952 was extremely limited. No outside consultant or contractor was called into the meetings or requested to investigate

> the problems and make estimates of the expected costs which any of these plans might involve."

In fact this second plan involved moving not only offices down to the basement, but various service departments such as the accounting department, the engineering department, and the laundry as well, and anticipated the creation of between 40 and 50 rentable rooms on the second floor (A 65). And, although outsiders were not brought in, estimates were made by petitioner's board and advisors, the conclusion being (A 65)

> "We came to the conclusion it would cost around $300,000. to restore the bus terminal space and make it useable for our purposes, and then we figured it would cost at least a couple of hundred thousand or more to restore the second floor into rooms and furnish them, get them ready for guest rooms."

To the same effect is testimony at A 54 and A 61.

While the Tax Court refers to the first plan in its Opinion (in part, as above quoted), it does not mention the second plan nor the estimate made in connection therewith.

It is the fact that from July, 1957, to the date of the trial petitioner could find no tenant for its basement despite its strenuous efforts to rent it (A 54), and the space remained unused.

The Circuit Court below affirmed the Tax Court's disposition of this point; expressly stating 277 Fed. 2d 528

> "In 1952 it became apparent that a principal tenant would not renew its lease when it expired in 1957. Management discussed the consequence and had the hotel engineer estimate the cost of remodeling if a new tenant could not be found. But no plans were adopted; no consideration of future earnings was had; the interest of King Hotels, Inc., owner of the building, was ignored; and the problem remained

a generality with the affairs of The Dixie, Inc. unchanged from previous years. In order to justify an accumulation as reasonable to meet a business need the need must be treated with economic reality and cannot find comfort in Section 102 by simple recognition. Here petitioner did nothing but recognize a future problem and discuss possible and alternative solutions. This is not sufficient. Definiteness of plan coupled with action taken toward its consummation are essentials."

Hotel Renovation

The Hotel Dixie is located in the Times Square area between 42nd and 43rd Streets. At all times pertinent hereto Hotel Lincoln (now Hotel Manhattan) containing approximately 1400 rooms has been located about one block north of the Dixie in the same area. In 1952 Hotel Lincoln was not a competitive threat because it was so run down. It was known to be on the market for sale, however, and petitioner's management knew that in new hands it would pose a competitive threat, which would have to be met. As found by the Tax Court (A 18)

> "It was expected that a new owner of the Hotel Lincoln would remodel the hotel at least to some extent which in turn would require a remodeling of the Hotel Dixie to maintain its competitive position. Just what the expected cost of remodeling would be was not known and depended mostly on the extent to which the Hotel Lincoln was remodeled."

In the words of petitioner's witness Reynolds (A 56)

> "We were right around the corner from a hotel of 1400 rooms, and if it came to pass that a competitor purchased that and redid the building—and I repeat, to redo the building necessitated a complete rebuilding—we would have to keep pace and pace our improvements in our hotel to arrive at a new hotel look at or about the time the new hotel would be opened."

In fact a competitor did purchase the Hotel Lincoln in May, 1956, shut it down and subsequently, as found by the Tax Court

> ". . . the hotel was renovated to a large extent, refurnished, completely televised, and airconditioned, and reopened for business about October 1, 1957, under the name of the Manhattan Hotel."

Petitioner's efforts to keep pace may be summarized, as to capital additions to the Hotel Dixie (apart from television and air conditioning) (A 19):

"1952	Neon signs	21,123.91
1953	Marquee	11,659.60
	Lobby survey	1,000.00
1956	Replacing front door	6,595.00
1957	Lobby improvements	61,354.45
	Electric signs	10,000.00
		112,032.96"

and, as to its stepped-up repairs and maintenance program (A 41):

"1953	.....	106,356.05
1954	.....	99,044.70
1955	.....	136,012.53
1956	.....	129,675.48
1957	.....	231,348.19
		702,436.95

which should be compared with prior years:

1948	.....	81,295.28
1949	.....	80,546.97
1950	.....	85,309.22
1951	.....	77,934.54
1952	.....	71,448.70
		396,534.71"

Unlike the Hotel Lincoln, the Hotel Dixie was not closed down during its refurbishing, but was kept operating.

The Tax Court determined that petitioner's plan to meet the threat of a renovated Lincoln was not a business need, its holding was (A 28)

> "While a program of extensive renovation of its facilities might well have represented a reasonable business purpose for at least a portion of petitioner's accumulation in 1952, the petitioner has failed completely to establish what sums it intended to spend or were needed for this purpose at that time."

The Circuit Court below affirmed the Tax Court's disposition of this point expressly stating (277 Fed 2d 528)

> "If such a vague plan were sufficient to avoid the corporate surtax, any individual could organize a one-man corporation, lease a building and discuss with the lessor the purchase of the building at some future time, and then assert that in the meantime business needs required accumulation of corporate earnings. Congress could never have intended Section 102 to be so easily evaded."

Prospective Future Income

Faced with the problems of air conditioning and television, petitioner's basement and the potential competitive threat of the Hotel Lincoln and their plans with respect thereto petitioner's directors and advisors were concerned, in 1952, about petitioner's prospect for future income (A 57, 67).

For guidance on this point they relied upon the opinion and advice of their special hotel consultant and advisor Rappaport as disclosed in his testimony (A 61, 62).

The only part of the Tax Court opinion relative to this point (and actually expressed in connection with an abandoned ground) was (A 28)

> "The petitioner submitted a nationwide statistical survey of some 375 hotels which indicated a declining rate of room occupancy during the years 1945-1952. However, despite the record of the remainder of the hotel industry, the affirmative evidence that the petitioner's own occupancy rates remained at a relatively high level throughout these years and was higher than that of most of its competitors in the Times Square area disproves the contention."

The survey referred to, petitioner's Exhibit 12, and admitted in evidence

> "As a showing of general cyclical trends of the hotel industry, but not as evidence of any particular statistical material" (A 63)

Although petitioner's own occupancy rates remained at a relatively high level, compared with immediate competitors, they consistently declined from 1948 through 1954. Its percentage of occupancy during each of the years 1948 through 1957 inclusive was as follows (A 42):

"1948.....	97%	1953.....	84%
1949.....	88%	1954.....	81%
1950.....	88%	1955.....	82%
1951.....	84%	1956.....	85%
1952.....	84%	1957.....	88%"

The only mention of this point by the Circuit Court below was, we submit, an erroneous one, i.e. (277 Fed. 2d. 528)

> ". . . no consideration of future earnings was had."

2. *As to burden of proof*: As determined by the Tax Court (A 22)

> "On October 4, 1955, the respondent notified petitioner that a deficiency was to be proposed pursuant to section 102 with respect to the accumulation of $80,193.14 in the year 1952, and provided petitioner with time to file the statement provided by section

> 534 of the 1954 Code: On October 31, 1955, petitioner submitted a statement to the respondent, as provided by section 534 of the 1954 Code, in which it stated grounds, and facts on which those grounds were based, for the accumulation of surplus."

The grounds and facts in petitioner's statement are set forth in petitioner's Appendix A 22 through A 26. The particular business needs of petitioner here in issue are indicated, i.e., the basement problem at A 24, A 25, and the renovation problem at A 22, A 23.

In its answer and thereafter respondent has taken the position that said statement does not set forth "grounds" as that term is contemplated by section 534, and or that said statement does not contain facts sufficient to show the basis of the alleged "grounds" (A 34).

On this issue the Tax Court determined (A 32).

> "With respect to the need for general renovation of the hotel and possible conversion of the bus depot, we would suppose that some accumulation might be reasonable. However, petitioner has failed to show, either by the statement filed by it pursuant to section 534 or by evidence introduced at the trial, what amounts were reasonably anticipated to be needed in either instance."

The Circuit Court below found it unnecessary to go into this question (277 Fed. 2d 527), although it was concerned with the question of business needs (Idem 528).

3. *As to petitioner's ultimate purpose.* The Tax Court (in a continuation of the immediately preceding quotation) determined (A 32)

> "Additionally, we think the fact that since its inception in 1942, petitioner has failed to pay any dividends while at the same time it had accumulated a surplus in the amount of $708,660.81 by the end of the year in question is affirmative evidence of the fact that peti-

tioner was availed of to avoid the imposition of surtax upon its shareholder. Section 102 makes the fact of an unreasonable accumulation determinative of the purpose to avoid surtax upon its shareholders.

"Under all the circumstances and upon the entire record, we conclude that the respondent did not err in determining that the accumulation of $80,193.14 in 1952 was for the purpose of preventing the imposition of surtax upon the petitioner's shareholder."

The Circuit Court below affirmed this finding.

4. *Jurisdiction of the Tax Court*

Respondent's notice of deficiency was mailed to Petitioner on January 17, 1956. Petitioner filed its petition in the Tax Court on March 27, 1956. Jurisdiction of the Tax Court is predicated upon 26 USC Secs. 6213 and 7442.

(f) *Reasons relied on for the allowance of the writ*

1. *As to business needs*

A. Petitioner's Annual Expenses

Every business has its overhead, and every business man, who can, lays something by to meet it. Any limitation imposed on this common variety of business prudence by Section 102 (or its current equivalent in the 1954 code) ought sensibly to be stated in such simple terms as to be clearly understood by the business man who must abide by it and the agent who must enforce it. Such a statement was that upon which Petitioner relied below and which evolved in the Tax Court in such cases as *F.E. Watkins Motor Co.*, 31 TC 288, i.e. (footnote 7) "This Court has consistently held that the accumulation of funds to meet operational expenses for at least one year is reasonable".

If the rule as stated is deemed to be too favorable to business men, then its correction should be confined to the period of overhead allowed i.e., nine months or six months

or even three months, instead of the stated one year. Such correction would not detract from the clarity of the rule, but merely reduce the number of cases in which it could be applied.

The sense and convenience of such a rule of thumb is not entirely denied by the Circuit Court below, for it states, 277 Fed. 2d 588,

> "The rule of thumb so stated may be one proper for administrative convenience but should rise to no higher level".

Obviously believing, however, that the stated rule is too favorable to Petitioner, the Circuit Court below made no effort to determine a suitable correction to the rule of thumb, but, instead, held that this question must be resolved by a factual, case by case, "search" (idem), without the benefit of such a rule. In so doing we submit that the Circuit Court below is in conflict with the Circuit Court of the Fourth Circuit in *Smoot Sand and Gravel Corp* v. *Com.* 241 Fed. 2d 197. There the Court, confronted with the stated rule but in doubt as to certain figures involved in its application, remanded the matter to the Tax Court expressly to have a rule of thumb made definite, and expressly mentioning the advantages of a clear rule in this situation, i.e. p. 207

> "A clear disclosure of the method by which the Court computed the working capital required would not only go a long way to dispose of the issues in the instant case but could be useful to the legal and accounting professions as a future guide".

We submit the case by case "search" insisted upon by the Circuit Court below in this connection commits business men, Respondent's agents, and the courts, to an endless series of expenses, in money and time, all of which could be avoided by a single sentence by this Court, i.e. an affirmance of the stated rule, or a correction of the rule as above indicated.

Because the question does affect all businessmen, Respondent and the Courts, and is differently treated in different circuits, we submit that its importance is such as to warrant an answer by this Court.

B. Petitioner's basement and renovation problems.

Petitioner's basement problem, in 1952, was of a kind that is continually confronting businessmen of all kinds, i.e. a problem which is recognized well before its ultimate solution can be sensibly fixed as to time and money spent. Petitioner's plan and action with respect to the problem, in 1952, i.e. to estimate and prepare for the worst (substantial alteration of its basement) while hoping for the best (that a tenant would be found who would not require extreme modification) was, we submit, the only plan and action which common sense suggests, or common business prudence would approve.

In holding that this plan and action does not suffice for Section 102 (and presumably for the equivalent Section of the 1954 Code), and holding that only plans finally definite as to time and money will so suffice, the Circuit Court below has ruled that this kind of problem, whatever its real exigencies, is arbitrarily excluded from those which will suffice in this connection.

We submit that this holding is in conflict with decisions in other Circuits exemplified by the holding in *Smoot Sand & Gravel Corp.* v. *Com.* 241 Fed. 2d. 197 (CCA4), at p. 206:

> "... a contingency is a reasonable need for which a business may provide, if the likelihood, not merely the possibility, of its occurence reasonably appears to a prudent business firm".

Because this kind of problem is so common in business, and Petitioner's answer—prepare for the worst while hoping for the best—is so obvious an answer, we submit that the Circuit Court's condemnation of that answer below is of such wide spread effect as to warrant this Court's review of it.

Petitioner's renovation problem is, we submit, as the Circuit Court below stated, similar in nature to its basement problem. It too is of a kind recognized well before its ultimate solution can be sensibly fixed as to time and money spent.

We urge a review of the disposition made of it below, therefore, upon the grounds we have stated above with respect to the basement problem.

2. *As to Burden of proof*

Section 534 of the 1954 Code (conceded to be applicable hereunder subsection (e)(2) thereof) provides:

> "SECTION 534. BURDEN OF PROOF.
>
> (a) GENERAL RULE.—In any proceeding before the Tax Court involving a notice of deficiency based in whole or in part on the allegation that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, the burden of proof with respect to such allegation shall— . . . if the taxpayer has submitted the statement described in subsection (c), be on the Secretary or his delegate with respect to the grounds set forth in such statement in accordance with the provisions of such subsection."

Said subsection (c) provides (under conditions here conceded) that

> " . . . the taxpayer may submit a statement of the grounds (together with facts sufficient to show the basis thereof) on which the taxpayer relies to establish that all or any part of the earnings and profits have not been permitted to accumulate beyond the reasonable needs of the business."

The Tax Court found as a fact that

> " . . . petitioner submitted a statement to respondent, as provided by section 534 of the 1954 Code, in which

> it stated grounds, and facts upon which those grounds were based, for the accumulation of surplus."

The issue here arises from respondent's attack upon the statement (with which the Tax Court substantially agreed), i.e., that said statement does not set forth "grounds" as that term is contemplated by section 534, and or that such statement does not contain facts sufficient to show the basis of the alleged "grounds".

While not exactly certain of the basis of the attack upon the grounds, we assume it must be one of the following:

> (1) that respondent was unable from the Statement to make out what grounds the petitioner was trying to set forth, and that consequently the Statement fails, by the standards of fair notice, substantially to inform respondent of what petitioner's position was.
>
> (2) that the statement sets forth grounds clearly enough, but the grounds set forth are not of the kind recognized under Sec. 102.

We submit that neither basis has substantial merit.

As to basis 1, it is plain that the Statement clearly sets forth the reasons for petitioner's accumulation herein set forth. And if extrinsic proof of this clarity is needed it is to be found in the fact that respondent was able to plead to the Statement (incorporated in the Petition), and did so in an answer which shows clearly that respondent understood what petitioner's position was. (Answer, A 70)

As to basis 2, we submit that the Tax Court itself expressly found that Petitioner's basement and renovation problems were of the right kind, i.e. (A 32)

> "With respect to the need for the general renovation of the hotel and possible conversion of the bus depot, we would suppose that some accumulation might be reasonable".

We therefore consider that the real basis, if any, of respondent's objections to petitioner's Statement is to be looked for in the second statutory requirement, i.e. that the Statement set forth facts "sufficient to show the basis" of the grounds.

It is conceded that Petitioner's statement presented some facts (i.e. Answer (A 71), Tax Court's finding (A 34). The question, therefore, is as to the quantity or quality of facts required.

In this connection we submit that the emphasized fact, conceded to be set forth in support of the ground, is the ultimate fact which, per se, supports the ground; and that the facts, the omission of which the pleading suggests is fatal, are isolated evidential facts, relevant to the ultimate fact perhaps, but not decisive, nor the only relevant facts which might be adduced in support of the ultimate fact.

Upon the foregoing it is plain that respondent's position is, in substance, that Section 534 (c) requires taxpayer's statement not only to show the ultimate facts upon which its grounds are based, but all the isolated evidential facts upon which its ultimate facts may rest. Or, in semantic terms, that the statutory phrase

> "(together with facts sufficient to *show* the basis thereof)"

means, really,

> "(together with facts sufficient to *prove* the basis thereof)".

It is equally plain that the Tax Court adopted respondent's position as to this point, interpreting petitioner's burden to *show* as one to prove, and judged petitioner's statement solely as evidence. Its holding was, in this connection (A 32)

> "... petitioner has failed to show, either by the statement filed by it pursuant to section 534 or by evidence introduced at the trial, what amounts were reasonably anticipated to be needed in either instance."

We submit that the Tax Court erred in its interpretation and application of section 534.

While "prove" is one of several varying meanings ascribed to the word "show" in modern dictionaries, it is not the meaning to be taken here. The authors of the phrase make that clear in their report to the Senate (Senate Report, No. 1622, 3 USC Cong. & Adm. News (1954) 4703).

"(Facts required)

> "Apart from changes made to conform this section with changes made in other sections your committee made only one substantive change in the House provision. The House provision requires that with the statement submitted by the taxpayer to shift the burden of proof there must also be submitted 'facts sufficient to apprise the Secretary or his delegate of the basis thereof.' Your committee believed this requirement was somewhat too rigid and has substituted 'facts sufficient to show the basis thereof.' (Senate Committee Report—Detailed Discussion)."

Plainly the meaning there intended is a synonym for both "apprise" and "show" (less rigid on the taxpayer than "apprise"). We submit, upon the following, that the meaning intended is "indicate" (Idem p. 4736)

"(Reason for change)

> "Your committee agrees with the House that this imposition of the burden of proof on the taxpayer has had several undesirable consequences. The poor record of the Government in the litigated cases in this area indicates that deficiencies have been asserted in many cases which were not adequately screened or analyzed. At the same time taxpayers were put to substantial expense and effort in *proving* that the accumulation was for the reasonable needs of the business. Moreover, the complaints of taxpayers that the tax is used as a threat by revenue agents to induce settlement on other issues appear to have

a connection with the burden of proof which the taxpayer is required to assume. It also appears probable that many small taxpayers may have yielded to a proposed deficiency because of the expense and difficulty of litigating their case under the present rules.

"(When burden shifts)

"Under the House and your committee's bill, the taxpayer may, upon receipt of notice of a proposed deficiency with respect to the accumulated earnings tax, file a statement of the grounds (together with sufficient facts to *indicate* the basis for the statement) on which the taxpayer relies to establish the reasonableness of the accumulation. If the taxpayer submits such a statement within the proper time, the burden of proof will be upon the Government as to whether the accumulation is in excess of the reasonable needs of the business." (emphasis added)

Upon the foregoing we submit that petitioner was not under a burden, in its Statement, of setting forth facts sufficient for "proving" the basis of its grounds, but only facts sufficient to "indicate" that basis. And further that the facts admittedly set forth in its Statement were more than sufficient to "indicate" the grounds.

The importance of this question generally, we submit, is plain from the expressions of those who enacted it. The enactment being recent, this Court has not stated what the precise application of the section is. Circuit Courts with an opportunity to make plain its provisions, have not done so (see the opinion of the Circuit Court below).

We submit under these circumstances that the question is one which this Court should review.

3. *Petitioner's ultimate purpose*

The Tax Court made no direct finding on this point. It stated and applied but one rule i.e. (A 32)

"Sec. 102 makes the fact of unreasonable accumulation determinative of the purpose to avoid surtax on its share holders."

This is not the correct rule, which is (Sec. 102 (c))

> "The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid surtax upon share holders *unless the corporation by the clear preponderance of the evidence shall prove to the contrary.*" (Emphasis added)

We submit that the petitioner was plainly entitled to make, and made the alternative defense contemplated by the emphasized part of the statute. As stated in *J. L. Goodman Furniture Co.*, 11 T.C. 530, 534:

> "This conclusion (that the taxpayer was not improperly availed of for the purpose of preventing surtax) for each year is justified if the petitioner shows that its accumulations of earnings at the end of each year were not beyond the reasonable needs of his business *or* if it shows in some other way, that its failure to distribute all of its earnings of each year is not for the purpose of preventing the imposition of the surtax upon its share holders." (Emphasis added)

Just as plainly the Tax Court, in applying the rule it stated, denied the defense any consideration, and, failing to make any finding, left unanswered the practical question the defense properly posed. Since such answer could have determined the case in petitioner's favor, we submit that the Tax Court's said disposition of the matter was error. Having found against Petitioner on the question of business needs (and hence, that said error of the Tax Court was not moot), the Circuit Court below should, we submit, have remanded the case back to the Tax Court for its consideration of the overlooked defense. Its failure to do this conflicts with the practice stated and applied by the Fourth Circuit in *Smoot Sand & Gravel Corp. v. Com.* 241 Fed. 2nd. 197 at p. 206, i.e. remand for consideration of issues unanswered,

and continues to deprive Petitioner of consideration of its aforesaid defense.

As the statute grants the right to this defense to everyone faced with Section 102 (and its current equivalent in the 1954 Code), we submit that the denial of it here under the circumstances mentioned is of importance general enough to warrant this Court's review of it.

CONCLUSION

Petitioner respectfully prays that a writ of certiorari be issued, directed to the United States Court of Appeals for the Second Circuit, to the end that this cause may be reviewed and determined by this Court as provided by the Statutes of the United States; and that the judgment herein of said United States Court of Appeals for the Second Circuit be reversed by this Court and for such further relief as to this Court may seem proper.

Dated: July 11, 1960

Respectfully submitted,

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APPENDIX A

OPINION OF THE CIRCUIT COURT BELOW

LEWIS, *Circuit Judge*:

Petitioner seeks review of a decision of the Tax Court upholding the assessment by the Commissioner of a deficiency of $22,053.11 in income surtax for the year 1952 against petitioner, a corporation owning and operating the Hotel Dixie in New York City. The assessment was made under Section 102[1] of the Internal Revenue Code of 1939 and was premised upon the Commissioner's disallowance of the sum of $258,660.81[2] from a total of $708,660.81 claimed by petitioner as a reasonable accumulation of profit and earnings. The balance was allowed as properly accumulated to meet the necessity of providing television and air conditioning for the hotel.

Attacking the ultimate finding of the Tax Court that "during the year 1952," petitioner was availed of for the purpose of avoiding surtax upon its shareholders," peti-

1. "(a) There shall be levied, collected, and paid for each taxable year * * * upon the net income of every corporation * * * if such corporation * * * is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting earnings or profits to accumulate instead of being divided or distributed, a surtax equal to the sum of the following:

   27½ per centum of the amount of the undistributed section 102 net income not in excess of $100,000, plus

   38½ per centum of the undistributed section 102 net income in excess of $100,000.

   * * * * * *

   (c) The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid surtax upon shareholders unless the corporation by the clear preponderance of the evidence shall prove to the contrary."

2. The sum of $80,193.14 was retained by the corporation during the year 1952.

tioner contends that it has shown that the earnings and profits of the corporation were accumulated for a recognized business purpose and not for the purpose of lightening the tax burdens of its sole shareholder, Hyman B. Cantor. The Commissioner, on the other hand, urges that the motive of the taxpayer was adequately proved to be that penalized by Section 102(a) without reference to the statutory presumption provided by subsection (c) and additionally that petitioner's evidence did not rise to a "clear preponderance" necessary to rebut the presumption properly applied. We find such ample support in the record, however viewed, for the finding of the Tax Court that we deem it unnecessary to determine the limitations of the statutory presumption set out in Section 102(c) or involve the determination of the case with the niceties of burden of proof indicated in Section 534 (26 U. S. C. A. 1954, 534).

The Dixie, Inc., was organized under the laws of New York in 1942 and has since been engaged in the operation of the Hotel Dixie in New York City. The company has been wholly owned by Hyman B. Cantor since inception. The premises of Hotel Dixie are owned by King Hotels, Incorporated, similarly organized in 1942 and wholly owned by Cantor and his wife. Carter Hotels Operating Corporation is a New York corporation organized in 1941 and wholly owned by Cantor and his wife. Carter serves as renting and managing agent for Hotel Dixie and Hotels Essex, Avery and George Washington, each of which is both owned and operated by a Cantor-owned corporation.[3]

3. Other companies owned or controlled by Cantor and intertwined in his hotel financing included:

New Haven Hotel Company, which owned the Hotel Garde.
Hotel George Washington, Inc., which leased the Hotel George Washington.
Essex, Inc., which operated the Hotel Essex.
Carter Hotels, Inc., which owned the Hotel Essex.
Hotel Essex, Boston, Corporation, which owned the Hotel Essex, Boston.
Avery, Inc., which operated the Hotel Avery.
Hotel Avery Corporation, which owned the Hotel Avery.
Hotel Governor Clinton Co., Inc.

Officers and directors of The Dixie, Inc., King Hotels, Incorporated, and Carter Hotels Operating Corporation are one and the same.

Cantor acquired the capital stock of The Dixie, Inc. in 1942 for $1,000 cash. During the next ten years the company accumulated over $700,000 as undistributed earnings and profits without declaring a single dividend. If the earnings of the company for the single year 1952 had been distributed to its sole stockholder, Cantor's additional surtax liability would have been $60,903.22. Cantor admitted that he was aware of this fact and since he actively directed The Dixie, Inc. his knowledge must be attributed to the taxpayer. There can be little doubt that taxpayer's accumulated earnings were resting for the convenience of Cantor. In fact, he testified when queried about his various hotel operations:

> "I never know until I close my deal just how and where we are going to put the deal. Usually, I tried to work those things out for the advantage of or the account of anyone [sic] of the hotels that have the cash to do it with."

Two contentions are advanced by petitioner in support of the claim that the accumulation was not beyond the reasonable needs of its business. In 1952 it became apparent that a principal tenant would not renew its lease when it expired in 1957. Management discussed the consequence and had the hotel engineer estimate the cost of remodeling if a new tenant could not be found. But no plans were adopted; no consideration of future earnings was had; the interest of King Hotels, Inc., owner of the building, was ignored; and the problem remained a generality with the affairs of The Dixie, Inc. unchanged from previous years. In order to justify an accumulation as reasonable to meet a business need the need must be treated with economic reality and cannot find comfort in Section 102 by simple recognition. Here petitioner did nothing but recognize a

future problem and discuss possible and alternative solutions. This is not sufficient. Definiteness of plan coupled with action taken toward its consummation are essentials. *I. A. Dress Co., Inc.* v. *Comm.*, 2 Cir., decided Jan. 11, 1960.

Petitioner's second attempt at establishing the 1952 accumulation as reasonable for its business needs is similar in nature and similarly without merit. During that year it was known that the Hotel Lincoln, a competitively located hotel, was for sale and if purchased and renovated would become a serious competitor. The problem could be met either by buying the Hotel Lincoln or refurbishing the Dixie. Cantor made some attempt toward negotiation for purchase but again the potential business need received nothing but vague recognition. "If such a vague plan were sufficient to avoid the corporate surtax, any individual could organize a one-man corporation, lease a building and discuss with the lessor the purchase of the building at some future time, and then assert that in the meantime business needs required accumulation of corporate earnings. Congress could never have intended Section 102 to be so easily evaded." *I. A. Dress Co., supra.*

Finally, petitioner contends that under the Tax Court's own rulings in *J. L. Goodman Co.* v. *Commissioner*, 11 T. C. 530 and *F. E. Watkins Motor Co.*, 31 T. C. 31 (footnote 7: "This Court has consistently held that the accumulation of funds to meet operational expenses for at least one year is reasonable") that its retention of the earnings and profits is *per se* reasonable in the context of its business, which incurs gross operating costs of over one million dollars per year.

The rule of thumb so stated may be one proper for administrative convenience but should rise to no higher level. The search must always be concerned with the needs of the particular business as they existed during the particular year. *KOMA, Inc.* v. *Comm.*, 10 Cir., 189 F. 2d 390; *World Pub. Co.* v. *United States*, 10 Cir., 169 F. 2d 186;

Appendix A

Hemphill Schools, Inc. v. *Comm.*, 9 Cir., 137 F. 2d 961; *Pelton Steel Casting Co.* v. *Comm.*, 7 Cir., 251 F. 2d 278.

The findings of the Tax Court are not clearly erroneous and the decision is affirmed.

APPENDIX B

OPINION OF THE TAX COURT BELOW

[357]

Petitioner asserts that the accumulation of $80,193.14 in the year 1952 was for the reasonable needs of its business and that petitioner corporation was not availed of for the purpose of avoiding the imposition of surtax upon its shareholders. We have found otherwise as a fact.

Whether the accumulation in any one year was for the reasonable needs of the business depends on the needs of the business, including anticipated needs as they existed during that particular year. *KOMA, Inc.* v. *Commissioner*, 189 F.2d 390 (C. A. 10, 1951), affirming a Memorandum Opinion of this Court dated December 14, 1949; *McCutchin Drilling Co.* v. *Commissioner*, 143 F.2d 480 (C. A. 5, 1944), affirming a Memorandum Opinion of this Court dated July 31, 1943.

Petitioner had accumulated $629,668.99 by the end of 1951 and accumulated a further $80,193.14 in 1952, the year here involved, for a total accumulated surplus of $708,660.81. The petitioner has alleged as grounds for the accumulation (1) a need for each constituent hotel in the Carter Hotels chain to contribute to the acquisition of new members, (2) a need to establish a surplus in view of the alleged economic depression in the hotel industry, (3) the need to purchase the Hotel Lincoln in order to protect the competitive position of the Hotel Dixie, (4) the need for

[358]

general renovation of the hotel, (5) the need to adapt the basement to use other than as a bus terminal, and (6) the need to install air conditioning and television.

Considering each of these claims in order, petitioner asserted in its statement filed with the respondent pursuant to section 534 of the 1954 Code that each member of the

Carter Hotels chain is required to contribute to the acquisition of new members in order that the overall operation be made more efficient and more profitable to each member
[359]
of the group. In order for the statement filed by a taxpayer under section 534(c) to be operative insofar as shifting the burden of proof to the respondent is concerned, the statement must not only show the grounds for the accumulation but must state facts sufficient to show the basis of those grounds. In the case of this particular ground for the accumulation, the statement filed by petitioner does not state such sufficient facts and is, thus, inadequate for the purpose of shifting the burden. The statement declared only that the Carter chain had been engaged actively in the search for new units, and that the cost of such acquisition could "reasonably be estimated to be more than one million dollars in cash." No facts were stated showing to what extent new acquisitions would make the existing operation more efficient or profitable. No facts were stated to show that the Carter chain was seeking to acquire any particular hotel. No facts were stated showing that petitioner's officers and board of directors ever discussed such a plan, let alone formulated or authorized any specific commitment in this connection. Moreover, no evidence was introduced at the trial which overcome these deficiencies. The entire record is devoid of any evidence supporting this ground for accumulation.

On the facts before us, the petitioner's allegation of economic depression in the hotel industry is unacceptable as a ground for the accumulation of surplus. The petitioner submitted a nationwide statistical survey of some 375 hotels which indicated a declining rate of room occupancy during the years 1945-1952. However, despite the record of the remainder of the hotel industry, the affirmative evidence that the petitioner's own occupancy rates remained at a relatively high level throughout these years and was higher than that of most of its competitors in the Times

Square area disproves the contention. Moreover, here again the statement filed under section 534 states no facts showing any discussion, planning, or action on the part of petitioner's officers and directors with respect to this particular ground for accumulation, nor was any evidence offered to show such facts at the trial.

Petitioner declared in the statement filed with respondent in 1955 that it would need $3,000,000 for the purchase of the Hotel Lincoln and substantial amounts in addition
[360]
for its subsequent rehabilitation, or, that, in the alternative, it would need considerable sums for renovation of the Hotel Dixie in the event that the Lincoln was purchased and then remodeled by some other interest. The expansion or improvement of existing facilities of a business may be a reasonable need for the purposes of section 102. See *William C. De Mille Productions, Inc.*, 30 B.T.A. 826 (1934), appeal dismissed 80 F.2d 1010 (C.A. 9, 1936). However, petitioner asserted that the purpose for the attempted purchase of the Hotel Lincoln was simply to eliminate a possible source of competition, without stating any facts to show how its ownership and rehabilitation of the Lincoln would protect the Hotel Dixie operation. Furthermore, even if we were to accept the purchase of the Lincoln as a possible reasonable business need of Dixie, the weight of the evidence is that the negotiations for its purchase were not conducted on the petitioner's behalf. All the evidence leads to the conclusion that the negotiations, such as they were, were conducted by or on behalf of Hyman B. Cantor, the owner of petitioner, in his personal capacity rather than that the Lincoln was intended to be acquired by petitioner.

While a program of extensive renovation of its facilities might well have represented a reasonable business purpose
[361]
for at least a portion of petitioner's accumulation in 1952, the petitioner has failed completely to establish what sums it intended to spend or were needed for this purpose at that

time. Except in the case of air conditioning and televising, which are considered separately below, petitioner's 1955 statement did not state any facts showing what amount was required in this connection or how much the petitioner's management in 1952 contemplated that such a general renovation would cost. Nor did it state facts showing that petitioner's officers and directors did in fact consider such a program in 1952. Under these circumstances, while we might be willing to assume that some renovation was required, the petitioner's statement filed in 1955 was insufficient to relieve it of the burden of establishing what amounts were required for this purpose. No evidence was offered at the trial which would establish such amounts.

Petitioner's statement filed with the respondent in 1955 stated a need to accumulate $300,000 to meet the cost of converting the basement upon the anticipated loss of the bus terminal as a tenant, without stating the facts upon which this or any other estimate made in this connection was grounded. Cantor, petitioner's sole stockholder, testified that the building engineer, based upon that individual's examination of the structure in 1952, estimated a possible cost of $500,000 for a complete conversion of the basement [362] involving removal of the supporting columns. The engineer himself did not testify. No written report made by him at the time of his supposed survey of the structure was offered or, so far as we know, was ever made. We do not know all of the assumptions used in his estimate or what factors he took into account. We do not even know what, if any, were his qualifications as an "engineer." Under the circumstances, the $500,000 estimate is entitled to little weight. Moreover, even if we were inclined to accept the estimate itself as reasonable, the basis for that estimate was apparently only one of a number of alternative plans for conversion of the basement, and there is no evidence that petitioner's officers or directors adopted it or any other plan of remodeling. On the contrary, the weight of the evidence

indicated that they hoped to find a new tenant who could use the basement facilities as they existed, with little or no renovation being required. As of the date of trial, no remodeling of the basement had been undertaken or authorized.

While the petitioner's statement filed in 1955 declared that the cost of air conditioning might reach $500,000, evidence at the trial showed that in 1952 about $300,000 was expected to be sufficient. The 1955 statement declared no facts showing what expenditure for television had been contemplated in 1952 and stated only the amount of orders which had since been placed in this connection. However, [363]
the evidence indicates that in 1952 it was anticipated that the installation of television would cost between $120,000 and $150,000. As set forth in our findings of fact, the petitioner has actually made substantial expenditures with respect to both air conditioning and television since 1952. While evidence of what the petitioner in fact did subsequent to 1952 does not of itself prove or disprove the reasonableness of an accumulation in that year, it bears upon the weight to be attached to the evidence of petitioner's intentions in 1952. We are willing to accept as reasonable the accumulation of up to $450,000 for air conditioning and television.

Petitioner had accumulated $708,660.81 by the end of 1952, of which amount we have accepted as reasonable the accumulation of $450,000 for air conditioning and television. Of the remaining $258,660.81, the respondent has only determined $80,193.14 to have been for the purposes prohibited by section 102. With respect to the need for general renovation of the hotel and possible conversion of the bus depot, we would suppose that some accumulation might be reasonable. However, petitioner has failed to show, either by the statement filed by it pursuant to section 534 or by evidence introduced at the trial, what amounts were reasonably anticipated to be needed in either instance. With

respect to the other grounds for accumulation asserted by it, the petitioner has either failed in its statement filed
[364]
pursuant to section 534 to state facts sufficient to support the grounds themselves or the weight of the evidence establishes affirmatively that there was no basis for the asserted ground. Additionally, we think the fact that since its inception in 1942, petitioner has failed to pay any dividends while at the same time it had accumulated a surplus in the amount of $708,660.81 by the end of the year in question is affirmative evidence of the fact that petitioner was availed of to avoid the imposition of surtax upon its shareholder. Section 102 makes the fact of an unreasonable accumulation determinative of the purpose to avoid surtax upon its shareholders.

Under all the circumstances and upon the entire record, we conclude that the respondent did not err in determining that the accumulation of $80,193.14 in 1952 was for the purpose of preventing the imposition of surtax upon the petitioner's shareholder.

Decision will be entered for the Respondent.

APPENDIX C

STATUTES AND REGULATIONS INVOLVED

SEC. 102 (1939 CODE). SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS.

(a) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year (in addition to other taxes imposed by this chapter) upon the net income of every corporation (other than a personal holding company as defined in section 501 or a foreign personal holding company as defined in Supplement P) if such corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting earnings or profits to accumulate instead of being divided or distributed, a surtax equal to the sum of the following:

> 27½ per centum of the amount of the undistributed section 102 net income not in excess of $100,000, plus
>
> 38½ per centum of the undistributed section 102 net income in excess of $100,000.

* * *

(c) *Evidence Determinative of Purpose.*—The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid surtax upon shareholders unless the corporation by the clear preponderance of the evidence shall prove to the contrary.

SEC. 39.102-2. (REGULATIONS, 1939 CODE).

(a) The Commissioner's determination that a corporation was formed or availed of for the purpose of avoiding the individual surtax is subject to disproof by competent

evidence. The existence or nonexistence of the purpose may be indicated by circumstances other than the evidence specified in the Internal Revenue Code, and whether or not such purpose was present depends upon the particular circumstances of each case. In other words, a corporation is subject to taxation under section 102 if it is formed or availed of for the purpose of preventing the imposition of surtax upon shareholders through the medium of permitting earnings or profits to accumulate, even though the corporation is not a mere holding or investment company and does not have an unreasonable accumulation of earnings or profits; and on the other hand, the fact that a corporation is such a company or has such an accumulation is not absolutely conclusive against it if, by clear and convincing evidence, the taxpayer satisfies the Commissioner that the corporation was neither formed nor availed of for the purpose of avoiding the individual surtax. . . .

SEC. 39.102-3. UNREASONABLE ACCUMULATION OF PROFITS.

(a) An accumulation of earnings or profits (including the undistributed earnings or profits of prior years) is unreasonable if it is not required for the purposes of the business, considering all the circumstances of the case. It is not intended, however, to prevent accumulations of surplus for the reasonable needs of the business if the purpose is not to prevent the imposition of the surtax. No attempt is here made to enumerate all the ways in which earnings or profits of a corporation may be accumulated for the reasonable needs of the business. Undistributed income is properly accumulated if retained for working capital needed by the business; or if invested in additions to plant reasonably required by the business; or if in accordance with contract obligations placed to the credit of a sinking fund for the purpose of retiring bonds issued by the corporation. The nature of the investment of earnings or profits is immaterial if they are not in fact needed in the business. Among other things, the nature of the business,

the financial condition of the corporation at the close of the taxable year, and the use of the undistributed earnings or profits will be considered in determining the reasonableness of the accumulations.

(b) The business of a corporation is not merely that which it has previously carried on, but includes in general any line of business which it may undertake. However, a radical change of business when a considerable surplus has been accumulated may afford evidence of a purpose to avoid the surtax. If one corporation owns the stock of another corporation in the same or a related line of business and in effect operates the other corporation, the business of the latter may be considered in substance although not in legal form the business of the first corporation. . . .

SEC. 534. (1954 CODE). BURDEN OF PROOF.

(a) *General Rule.*—In any proceeding before the Tax Court involving a notice of deficiency based in whole or in part on the allegation that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, the burden of proof with respect to such allegation shall—

(1) if notification has not been sent in accordance with subsection (b), be on the Secretary or his delegate, or

(2) if the taxpayer has submitted the statement described in subsection (c), be on the Secretary or his delegate with respect to the grounds set forth in such statement in accordance with the provisions of such subsection.

(b) *Notification by Secretary.*—Before mailing the notice of deficiency referred to in subsection (a), the Secretary or his delegate may send by *certified mail or* registered mail a notification informing the taxpayer that the proposed notice of deficiency includes an amount with respect

18 the accumulated earnings tax imposed by section 531. In the case of a notice of deficiency to which subsection (c)(2) applies and which is mailed on or before the 30th day after the date of the enactment of this sentence, the notification referred to in the preceding sentence may be mailed at any time on or before such 30th day.

(c) *Statement by Taxpayer.*—Within such time (but not less than 30 days) after the mailing of the notification described in subsection (b) as the Secretary or his delegate may prescribe by regulations, the taxpayer may submit a statement of the grounds (together with facts sufficient to show the basis thereof) on which the taxpayer relies to establish that all or any part of the earnings and profits have not been permitted to accumulate beyond the reasonable needs of the business.

* * *

(e) *Application of Section.*—

(1) Notwithstanding any other provision of law, this section shall apply with respect to taxable years to which this subchapter applies and (except as provided in paragraph (2)) to taxable years to which the corresponding provisions of prior revenue laws apply.

(2) In the case of a notice of deficiency for a taxable year to which this subchapter does not apply, this section shall apply only in the case of proceedings tried on the merits after the date of the enactment of this paragraph.

SEC. 1.534-2. (REGULATIONS, 1954 CODE). (TD 6377, FILED 5-12-59). BURDEN OF PROOF AS TO UNREASONABLE ACCUMULATIONS IN CASES BEFORE THE TAX COURT.

(a) *Burden of proof on Commissioner.* Under the general rule provided in section 534(a), in any proceeding

before the Tax Court involving a notice of deficiency based in whole or in part on the allegation that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, the burden of proof with respect to such allegation is upon the Commissioner if—

(1) A notification, as provided for in section 534(b) and paragraph (c) of this section, has not been sent to the taxpayer; or

(2) A notification, as provided for in section 534(b) and paragraph (c) of this section, has been sent to the taxpayer and, in response to such notification, the taxpayer has submitted a statement, as provided in section 534(c) and paragraph (d) of this section, setting forth the ground or grounds (together with facts sufficient to show the basis thereof) on which it relies to establish that all or any part of its earnings and profits have not been permitted to accumulate beyond the reasonable needs of the business. However, the burden of proof in the latter case is upon the Commissioner only with respect to the relevant ground or grounds set forth in the statement submitted by the taxpayer, and only if such ground or grounds are supported by facts (contained in the statement) sufficient to show the basis thereof.

(b) *Burden of proof on the taxpayer.* The burden of proof in a Tax Court proceeding with respect to an allegation that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business is upon the taxpayer if—

(1) A notification, as provided for in section 534(b) and paragraph (c) of this section, has been sent to the taxpayer and the taxpayer has not submitted a statement, in response to such notification, as provided in section 534(c) and paragraph (d) of this section; or

(2) A statement has been submitted by the taxpayer in response to such notification, but the ground or grounds on which the taxpayer relies are not relevant to the allegation or, if relevant, the statement does not contain facts sufficient to show the basis thereof.

(c) *Notification to the taxpayer.* Under section 534(b) a notification informing the taxpayer that the proposed notice of deficiency includes an amount with respect to the accumulated earnings tax imposed by section 531 may be sent by registered mail (or by certified or registered mail, if the notification is mailed after September 2, 1958) to the taxpayer at any time before the mailing of the notice of deficiency in the case of a taxable year beginning after December 31, 1953, and ending after August 16, 1954.

(d) *Statement by taxpayer.* (1) A taxpayer who has received a notification, as provided in section 534(b) and paragraph (c) of this section, that the proposed notice of deficiency includes an amount with respect to the accumulated earnings tax imposed by section 531, may, under section 534(c), submit a statement that all or any part of the earnings and profits of the corporation have not been permitted to accumulate beyond the reasonable needs of the business. Such statement shall set forth the ground or grounds (together with facts sufficient to show the basis thereof) on which the taxpayer relies to establish that there has been no accumulation of earnings and profits beyond the reasonable needs of the business. See paragraphs (a) and (b) of this section for rules concerning the effect of the statement with respect to burden of proof.

(2) The taxpayer's statement, under section 534(c) and this paragraph, must be submitted to the Internal Revenue office which issued the notification (referred to in section 534(b) and paragraph (c) of this section) within 60 days after the mailing of such notification. If the taxpayer is

unable, for good cause, to submit the statement within such 60-day period, an additional period not exceeding 30 days may be granted upon receipt in the Internal Revenue office concerned (before the expiration of the 60-day period provided herein) of a request from the taxpayer, setting forth the reasons for such request.

SEC. 1.534-4. TAXABLE YEARS SUBJECT TO THE INTERNAL REVENUE CODE OF 1939.

The rules prescribed in §§ 1.534-1 to 1.534-3, inclusive, apply in any proceeding tried on the merits after August 11, 1955, before the Tax Court and involving a notice of deficiency in surtax imposed by section 102 of the Internal Revenue Code of 1939, for a taxable year subject to such Code, based in whole or in part on the allegation that all or any part of the earnings and profits of the taxpayer have been permitted to accumulate beyond the reasonable needs of the business. If a notice of deficiency for a taxable year described in the preceding sentence was mailed before September 11, 1955, a notification mailed before that date shall be effective as fully as though such notification had been mailed before the notice of deficiency was mailed.

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FILED
AUG 8 1960
JAMES R. BROWNING, Clerk

No. 234

In the Supreme Court of the United States

OCTOBER TERM, 1960

THE DIXIE, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. A5–A32)[1] are reported in 31 T.C. 415. The opinion of the Court of Appeals (Pet. 23–27) is reported at 277 F. 2d 526.

JURISDICTION

The judgment of the Court of Appeals was entered on April 14, 1960. (Pet. 1.) The petition for a writ of certiorari was filed on July 13, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

[1] Record references are to the appendix to the taxpayer's brief, separately bound, filed in the Court of Appeals.

QUESTION PRESENTED

Whether the two courts below were correct in finding that during 1952 the taxpayer was availed of for the purpose of avoiding surtax upon its shareholders by means of permitting earnings and profits to accumulate and, therefore, is liable for the surtax imposed by Section 102 of the Internal Revenue Code of 1939.

STATUTES INVOLVED

The pertinent portions of Section 102 (a) and (c) of the Internal Revenue Code of 1939, and Section 534 (a) (1) and (2), (b), (c) and (e) (1) and (2) of the Internal Revenue Code of 1954 are set out in the Appendix, *infra*, pp. 9–11.

STATEMENT

The facts as found by the Tax Court (R. A5–A26), and as stated by the Court of Appeals (Pet. 23–25), may be summarized as follows:

The taxpayer is a corporation which was organized under the laws of the State of New York in 1942, and at all times pertinent hereto has been engaged in the operation of the Hotel Dixie in New York City. (R. A5–A6.) The company has been wholly owned by Hyman B. Cantor since its creation. (R. A7.) The premises of the Hotel Dixie are owned by King Hotels, Incorporated (hereinafter referred to as King), similarly organized in 1942 and wholly owned by Cantor and his wife. Carter Hotels Operating Corporation (hereinafter referred to as Carter) was organized in 1941 under the laws of New York and

was wholly owned by Cantor and his wife. Carter served as renting and managing agent for the Hotel Dixie and for the hotels Essex, Avery, and George Washington, each of which was both owned and operated by a Cantor-owned corporation. (R. A6.) At all times pertinent hereto Cantor was president and treasurer of the taxpayer, and also of Carter and King; his wife was assistant secretary of the same companies. The third officer of the taxpayer, the vice-president and secretary, was replaced from time to time, but while he was vice-president and secretary of the taxpayer he held the same office in Carter and King. (R. A15.)

When the taxpayer was organized in 1942, Cantor paid $1,000 for all of its stock. (R. A5–A6, A7.) By 1952, the taxable year, its accumulated surplus was about $708,000, and after 1952 it continued to accumulate all of its earnings and profits. During the taxpayer's entire existence it never declared a dividend. (R. A21.) For the year 1952 the taxpayer reported a normal tax and surtax net income in the amount of about $155,000, and an income tax liability in the amount of about $75,000. After the payment of the above tax the taxpayer retained the balance of its net income, about $80,000. (R. A6.) If the taxpayer's earnings for 1952 had been distributed to Cantor, its sole stockholder, his additional surtax liability would have been about $60,000. (R. A21.)

On October 4, 1955, the Commissioner notified the taxpayer that a deficiency was to be proposed pursuant to Section 102 with respect to the accumulation

of $80,193.14 in the year 1952, and gave the taxpayer time to file the statement provided by Section 534 of the Internal Revenue Code of 1954. On October 31, 1955, the taxpayer submitted to the Commissioner a statement in which it purported to set forth grounds for the accumulation of surplus. (R. A22.) On January 17, 1956, the Commissioner notified the taxpayer of a determination of a deficiency in income taxes for the year 1952 pursuant to Section 102 of the 1939 Code. (R. A26.). The taxpayer filed a petition with the Tax Court, which found that during the year 1952 the taxpayer was availed of for the purpose of avoiding surtax upon its shareholders (R. A26), and accordingly entered a decision against the taxpayer (R. A4). Thereupon, the taxpayer appealed to the Court of Appeals for the Second Circuit, which decided that the Tax Court's determination was supported by the record and not clearly erroneous, and should be affirmed. (Pet. 23–27.)

ARGUMENT

The narrow factual issue here presented does not warrant further review. At the last term the Court declined to review two cases involving the application of Section 102 of the Internal Revenue Code of 1939 to factual situations generally similar to that here. *I. A. Dress Co.* v. *Commissioner*, 273 F. 2d 543 (C.A. 2d), certiorari denied, 362 U.S. 976; *Smoot Sand & Gravel Corp.* v. *Commissioner*, 274 F. 2d 495 (C.A. 4th), certiorari denied, 362 U.S. 976.

The purpose of Section 102 of the 1939 Code (Appendix, *infra*, pp. 9–10) is to compel a corporation to distribute its earnings and profits so that individual stockholders will become liable for tax on the dividends received. *Helvering* v. *Chicago Stock Yards Co.*, 318 U.S. 693, 699. Accordingly, subsection (a) of Section 102 (Appendix, *infra*, p. 9) imposes a surtax on a corporate taxpayer if one of its purposes for accumulating earnings and profits was to avoid the imposition of tax upon its shareholders. The taxpayer, under principles applicable in income tax cases generally, has the burden of disproving the Commissioner's findings. Indeed, subsection (c) of Section 102 (Appendix, *infra*, pp. 9–10) provides that, if an accumulation is beyond the reasonable needs of the business, that fact increases the taxpayer's burden so that it must then disprove the proscribed purpose by a clear preponderance of the evidence. These are, of course, questions of fact and the trial court's findings are sustained unless clearly erroneous. *Helvering* v. *Chicago Stock Yards Co.*, *supra*, p. 700; *Helvering* v. *Nat. Grocery Co.*, 304 U.S. 282, 295.

The Tax Court found that the taxpayer's earnings and profits for the year 1952 were accumulated beyond the reasonable needs of its business (R. A31–A32), and that this was done for the purpose of preventing the imposition of surtax upon Cantor, its sole stockholder (R. A7, A26, A32). The court below, after reviewing the evidence, held that there was ample support in the record for the Tax Court's finding

that the taxpayer was availed of for the purpose of avoiding surtax upon its shareholder (Pet. 24), and that the findings are not clearly erroneous (Pet. 27).[1] The concurrent findings of fact by the two courts below are entitled to finality here. *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 51; *Comstock* v. *Group of Investors*, 335 U.S. 211, 214.

Some of the factors which support the findings below are: the taxpayer has never declared a dividend though it was successful and had accumulated more than $708,000 by the year 1952 (R. A21); Cantor, the sole stockholder (R. A7), was aware of the fact that if he distributed earnings of the taxpayer to himself, he would have incurred a large additional tax liability (R. A21; Tr. 101);[2] as a result of the taxpayer's never having declared a dividend, the accumulated earnings and profits increased to more than $708,000 (R. A21); the taxpayer's accumulated earnings were held for the convenience of Cantor (Pet. 25); the accumulated earnings were not, so far as the record shows, formally devoted to any specific purpose; and the alleged plans for remodeling the basement of the

[1] Indeed, the court below found such ample support in the record, however viewed, for the finding of the Tax Court that it was deemed unnecessary to determine the limitations of the statutory presumption set out in Section 1(24(c) of the 1939 Code or to involve the determination of the case with the niceties of burden of proof indicated in Section 534 of the 1954 Code (Appendix, *infra*, pp. 10-11). (Pet. 16-20, 24.)

[2] "Tr." references are to the portions of the testimony printed in Appendix B of the Commissioner's brief filed in the court below, which has been filed as part of the record before this Court.

Hotel Dixie or of purchasing another hotel in the vicinity of the taxpayer were vague and indefinite (R. A16-A18, A29-A31).

Contrary to the taxpayer's contention (Pet. 14-15), the decision below plainly is not in conflict with the decision of the Fourth Circuit in *Smoot Sand & Gravel Corp.* v. *Commissioner*, 241 F. 2d 197, certiorari denied, 354 U.S. 922. That case turned upon its particular facts with respect to the amount of working capital there required; and, indeed, no rule or formula applicable to all cases with respect to the amount of working capital required was laid down by the Fourth Circuit upon its eventual disposition of the litigation after remand to the Tax Court. *Smoot Sand & Gravel Corp.* v. *Commissioner*, decided December 31, 1958 (1958 P-H T.C. Memorandum Decisions, par. 58,221), affirmed, 274 F. 2d 495 (C.A. 4th), certiorari denied, 362 U.S. 976. Nor is there any conflict here with the Fourth Circuit's observation in its first opinion in the *Smoot Sand & Gravel Corp.* case (241 F. 2d 197, 206) that a contingency is a reasonable need for which a business may provide, if the likelihood, not merely the possibility, of its occurrence reasonably appears. (Pet. 15.) The court below held only that the mere recognition of a business need is not enough; in order to justify an accumulation as reasonable, the need must be treated with definiteness of plan coupled with action taken toward its consummation. (Pet. 25-26.) *I.A. Dress Co.* v. *Commissioner*, 273 F. 2d 543 (C.A. 2d), certiorari denied, 362 U.S. 976.

CONCLUSION

The petition for certiorari should be denied.
Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1939:

SEC. 102. SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS.

(a) [As amended by Sec. 103(d), Revenue Act of 1941, c. 412, 55 Stat. 687] *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year (in addition to other taxes imposed by this chapter) upon the net income of every corporation (other than a personal holding company as defined in section 501 or a foreign personal holding company as defined in Supplement P) if such corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting earnings or profits to accumulate instead of being divided or distributed, a surtax equal to the sum of the following:

27½ per centum of the amount of the undistributed section 102 net income not in excess of $100,000, plus

38½ per centum of the undistributed section 102 net income in excess of $100,000.

* * * * *

(c) *Evidence Determinative of Purpose.*—The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid surtax upon shareholders unless the corporation by the clear

preponderance of the evidence shall prove to the contrary.

* * * * *

(26 U.S.C. 1952 ed., Sec. 102.)

Internal Revenue Code of 1954:

SEC. 534. BURDEN OF PROOF.

(a) *General Rule.*—In any proceeding before the Tax Court involving a notice of deficiency based in whole or in part on the allegation that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, the burden of proof with respect to such allegation shall—

(1) if notification has not been sent in accordance with subsection (b), be on the Secretary or his delegate, or

(2) if the taxpayer has submitted the statement described in subsection (c), be on the Secretary or his delegate with respect to the grounds set forth in such statement in accordance with the provisions of such subsection.

(b) [As amended by Sec. 5 of the Act of August 11, 1955, c. 805, 69 Stat. 689] *Notification by Secretary.*—Before mailing the notice of deficiency referred to in subsection (a), the Secretary or his delegate may send by registered mail a notification informing the taxpayer that the proposed notice of deficiency includes an amount with respect to the accumulated earnings tax imposed by section 531. In the case of a notice of deficiency to which subsection (c)(2) applies and which is mailed on or before the 30th day after the date of the enactment of this sentence, the notification referred to in the preceding sentence may be mailed at any time on or before such 30th day.

(c) *Statement by Taxpayer.*—Within such time (but not less than 30 days) after the mailing of the notification described in subsection

(b) as the Secretary or his delegate may prescribe by regulations, the taxpayer may submit a statement of the grounds (together with facts sufficient to show the basis thereof) on which the taxpayer relies to establish that all or any part of the earnings and profits have not been permitted to accumulate beyond the reasonable needs of the business.

* * * * *

(e) [as amended by Sec. 4 of the Act of August 11, 1955, *supra*] *Application of Section.*—

(1) Notwithstanding any other provision of law, this section shall apply with respect to taxable years to which this subchapter applies and (except as provided in paragraph (2)) to taxable years to which the corresponding provisions of prior revenue laws apply.

(2) In the case of a notice of deficiency for a taxable year to which this subchapter does not apply, this section shall apply only in the case of proceedings tried on the merits after the date of the enactment of this paragraph.

(26 U.S.C. 1958 ed., Sec. 534.)